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Deputy Commissioner, Policy and Strategy
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Dear Emma

Investment income withholding and reporting: intermediary entities

We are pleased to respond to *"Investment income withholding and reporting requirements: investment products provided via intermediary entities"* (the "consultation document").

General comment

KPMG supports the broad approach to align the investment income reporting and tax withholding requirements for custodians. We also support the provision of flexibility for reporting and withholding obligations to be transferred between payers and custodians (and between custodians). This recognises current commercial arrangements.

We also support treating a global custodian as the end investor for a NZ custodian. This is a pragmatic alternative which reduces the otherwise significant costs and compliance obligations on NZ custodians to source information about global custodians' investors.

Our detailed comments are outlined below.

Definition of "custodial institution"

The proposal is to limit these new rules to entities that meet the CRS definition of "custodial institution" that are also regulated by the Financial Markets Authority ("the FMA") or an equivalent overseas body.

We note that this is designed to quarantine the proposed rules, which are concessionary, to regulated custodians and intermediaries to limit scope for abuse. We agree with this rationale, but make the following recommendations:

- Strictly, we understand that the FMA supervises custodians rather than regulates them. Custodians are required to register as a financial services provider but are not licensed (in the same way they are in overseas jurisdictions). The reference to being "regulated by the FMA" should therefore be confirmed for its technical correctness.
- Regulatory bodies, from a New Zealand perspective, should also include the Reserve Bank of New Zealand and the Department of Internal Affairs. The latter in respect of anti-money laundering obligations as that is an equivalent to CRS/FATCA obligations.
- We agree that the "custodial institution" definition for CRS purposes should be the starting point. However, in practice, a financial services group may have multiple entities which provide services and derive income. For example, many groups will have a nominee company which is the legal owner and custodian of the underlying assets but which derives

no income from that activity. The income from the activity is actually derived by another entity in the group. Accordingly:

- The ability to use the new rules should be broad, by reference to a group that offers custodial or intermediary type services and/or is subject to the relevant regulation or supervision, including where another group entity or type of financial institution for CRS purposes – e.g. a "depositary institution" or "investment entity" – derives the income; and
- The practical application of the rules needs to take into account who currently undertakes the relevant obligations in the group. For example, if the nominee company currently accounts for the withholding tax (under its name and its IRD number), it should be possible for that process to continue.

— "PIE proxies", to the extent that they do not meet the CRS definition of "custodial institution", should also be entitled to apply the rules. We note that they are effectively "regulated" by Inland Revenue as they have existing tax withholding and reporting obligations.

Requirement to agree and ability to rely on prior payers

A payment may pass through a chain of custodians and other intermediaries before it reaches an ultimate investor.

A custodian, in the middle of a chain, may not be aware of agreements made (or not made) by earlier payers. There is a necessary implication that if the immediate payer seeks an agreement to pass reporting and withholding obligations, that the immediate payer (and earlier payers) have the required agreement(s). The rules should allow this as a practical outcome rather than requiring evidence of actual agreement for each step in the chain.

Passing on withholding and reporting obligations would be by agreement. Therefore, if no agreement is reached, then the underlying investor information must be passed on to allow a relevant payer to comply with the obligations. Although we would expect that payers, custodians and other intermediaries would reach agreement, there may be legal or group policy or commercial requirements, which make particular intermediaries unwilling to agree to either withhold or to report.

Consideration may need to be given to whether the obligation to pass on information (in the absence of an agreement) should be explicitly legislated and, if so, what the consequences of failing to do so should be. (This could be way of rules similar to the information requirements on account holders for CRS and FATCA.)

We recommend that this be discussed with industry participants.

New Zealand presence

We note the document has inconsistent references to the requirement for New Zealand presence to be able to participate in the transfer of withholding and reporting obligations. It is possible that non-residents currently have withholding obligations. At a minimum, their position should be grand-parented. However, we consider the preferable outcome is to define what is required for Inland Revenue to accept that a non-resident can use the proposed rules. This may require formal acceptance and notification (e.g. through a registration process for non-residents) as well as an objective test of how the non-resident operates.

Clarifying the withholding requirements for custodial institutions

The proposal is to align the withholding provisions across RWT, NRWT and AIL to ensure that they are consistent with each other and the requirements for passing on withholding obligations in the context of custodial institutions are clearer and more certain.

In summary, we understand the proposed rules are intended to:

- Allow RWT, NRWT and AIL withholding obligations to be passed by the payer to a custodial institution via an "opt in/out" process.
- Allow a custodial institution to pass the obligations to another custodial institution in the chain (again via an "opt in/out" process) or a related party of the custodian (if the custodian has systems constraints which prevent withholding).
- Require the last custodial institution in the chain (that is, before a non-custodian NZ beneficiary or a foreign custodian or beneficiary) to withhold tax.
- Treat foreign custodians as the investor for withholding tax purposes and allow aggregate level withholding (i.e. based on DTA/non-DTA status and tax rates for different types of investment income) where the end investor is not known. This would be subject to the NZ custodian putting onus on the foreign custodian to provide the correct information.
- Allow the reporting of investment income to also be passed from the payer to a custodial institution or between custodial institutions (again, using an "opt in/out" mechanism). While the default position would be that withholding and reporting obligations should be aligned, there would be flexibility for commercial arrangements that split these obligations to be respected.
- Treat foreign custodians as the end investor for reporting purposes and allow aggregate level reporting, unless the NZ custodian has information about the foreign custodian's end investors.

We support the broad approach outlined above.

While the flexibility to transfer obligations (both withholding and reporting) is supported, the mechanism to achieve this needs to be clear. We have outlined some of the practical issues that will need to be confirmed and our recommendations:

- We do not believe a registration regime for NZ custodians eligible for the withholding and reporting rules is required. Inland Revenue will have visibility via the entry criteria (as well as through CRS and other reporting). However, if a registration regime is implemented, this need to be straight forward to comply with to minimise compliance costs on providers.
- Opting-in/out of obligations should need to have the consent of both parties and it should be sufficient for payers and custodians to document this as part of their normal commercial agreements. This will minimise compliance costs. (We note that there is precedent for this in the FDR & FX hedging rules, where elections to apply these rules must be kept by the PIE.)
- The commercial agreements with global custodian to provide information at an aggregate level on the status of their investors should be sufficient evidence that they can treat the global custodian as the end investor. Custodians necessarily rely on each other's systems and processes to correctly deal with the tax obligations for underlying investors. This includes a normal process for correction of errors. That should not be seen as evidence that the global custodian cannot be relied on. We also note that the requirement for regulation or supervision should provide comfort to Inland Revenue.
- Differing arrangements should be allowed for custodians in relation to different intermediary "clients". A custodian may have some intermediaries, which it acts for, which agree to undertake obligations, and others which do not. This may apply to a single investment – e.g. Company ABC shares are held by Custodian 1 for Custodian 2 (where there is an agreement) and for Custodian C (where there is no agreement). Custodian 1 should be able to advise Company ABC of the separate arrangements.

Consequential issues

We have assumed that Inland Revenue will have the systems and processes to achieve its objective of populating investment income and tax credit information for New Zealand resident individuals. However, it needs to consider the level of detail that it can provide to investors and, with custodians and other intermediaries, how this is best dealt with.

For example, a custodian will report to the investor, their income and tax withheld by the underlying investment. We assume that Inland Revenue would receive aggregate investment income and withholding tax information from the custodian for each investor. This would then be populated in the investor's *MyIR* account as income and tax credits from the custodian, which would not match what the investor has been advised. (Further, the payer in Inland Revenue's system may not match the investor's counter-party. For example, the investor may consider they have funds with their broker, but it is the broker's nominee company which actually pays the withholding tax and reports the investment income to Inland Revenue.)

This appears to be a practical result but would require careful communication to avoid confusion.

Legislation

The legislative design and detail will be very important to the proposed rules operating as intended. Draft legislation should be circulated to interested parties for comment at the earliest opportunity and with as long a lead time as possible. It would also be useful to "work shop" the draft to allow for quick and efficient feedback.

KPMG would be happy to provide comment on any draft legislation or even drafting instructions.

Remedial matters

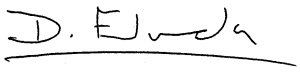
The remedial matters being consulted on are:

- *Clarifying the rules for error correction where NRWT has been deducted instead of AIL.* The proposal is to clarify that adjustments can only be made where there is a time delay communicating to the issuer a change in the investor base eligible for AIL or to put investors in the position they were always entitled to. We support this clarification.
- *Allowing consistent FX rates for investor and withholding.* The proposal is to amend section RE 4(7) to permit the transaction date FX rate to be used for both reporting and calculating withholding. We support an amendment to align FX rates.
- *Including foreign tax credits in investment income reporting information.* The proposal, as we understand it, is to require foreign tax credit information to be separately reported in future. We recommend that this be canvassed with affected custodians and intermediaries, given the potential system impact.

Further information

Please do not hesitate to contact us, should you have any questions about our submission.

Yours sincerely



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